APPENDIX A

LIST OF COMMENTERS

Petitions To Deny

Center for Digital Democracy ("CDD")
EchoStar Satellite Corporation ("EchoStar")
National Hispanic Media Coalition ("NHMC")
National Rural Telecommunications Cooperative ("NRTC")

Initial Comments

Advance/Newhouse Communications, Cable One, Cox Communications & Insight Communications ("JCC")
American Cable Association ("ACA")
Association of Public Television Stations and the Public Broadcasting Service ("APTS")
Cablevision Systems Corporation ("Cablevision")
Intelsat Global Service Corporation ("Intelsat")
Johnson Broadcasting of Dallas, Inc. ("Johnson")
Maranatha Broadcasting Company, Inc. ("Maranatha")
Microcom ("Microcom")
National Association of Broadcasters ("NAB")
RCN Telecom Services, Inc. ("RCN")

Opposition and Reply Comments

General Motors, Hughes Electronics Corporation and The News Corporation Limited ("Applicants")

Reply Comments

Advance/Newhouse Communications, Cable One, Cox Communications & Insight Communications ("JCC")
American Cable Association ("ACA")
Cablevision Systems Corporation ("Cablevision")
Consumer Federation of America, Consumers Union, Center for Digital Democracy & Media Access Project ("CFA")
Maranatha Broadcasting Company, Inc. ("Maranatha") (late-filed)
National Hispanic Media Coalition ("NHMC") (late-filed)

APPENDIX B

MODIFICATIONS TO RULES FOR ARBITRATION INVOLVING REGIONAL SPORTS NETWORKS

1 We modify the Rules in several respects as they apply to arbitration involving regional sports networks.

2. **Initiation of Arbitration.** Arbitration shall be initiated as provided in Rule R-4 except that, under Rule R-4 (a) (ii) the MVPD shall not be required to submit copies of the arbitration provisions of the contract, but shall instead refer to this Order in the demand for arbitration. Such reference shall be sufficient for the AAA to take jurisdiction.

3. **Appointment of the Arbitrator.** Appointment of an arbitrator shall be in accordance with rule E-4 of the Rules. Arbitrators included on the list referred to in rule E-4 (a) of the Rules shall be selected from a panel jointly developed by the American Arbitration Association and the Commission and will be based on the following criteria:

The arbitrator shall be a lawyer admitted to the bar of a state of the United States;

The arbitrator shall have been practicing law for at least 10 years;

The arbitrator shall have prior experience in mediating or arbitrating disputes concerning media programming contracts;

The arbitrator shall have negotiated or have knowledge of the terms of comparable cable programming network contracts.

4. **Exchange of Information.** At the request of any party, or at the discretion of the arbitrator, the arbitrator may direct the production of current and previous contracts between either of the parties and MVPDs, broadcast stations, video programming networks, and sports teams, leagues, and organizations as well as any additional information that is considered relevant in determining the value of the programming to the parties. Parties may request that access to information of a commercially sensitive nature be restricted to the arbitrator and outside counsel and experts of the opposing party.

5. **Administrative Fees and Expenses.** If the arbitrator finds that one parties' conduct, during the course of the arbitration, has been unreasonable, the arbitrator may assess all or a portion of the other parties costs and expenses (including reasonable attorneys' fees) against the offending party.

6. **Locale.** In the absence of agreement between the parties, the arbitration shall be held in the city that contains the headquarters of the MVPD.

7 **Form of Award.** The arbitrator shall render a written award containing the arbitrator's findings of fact and reasons supporting the award. If the award contains confidential information, the arbitrator shall compile two versions of the award; one containing the confidential information and one with such information redacted. The version of the award containing the confidential information shall only be disclosed to persons bound by the Protective Order issued in connection with the arbitration. The parties shall include such confidential version in the record of any review of the arbitrator's decision by the Commission.

APPENDIX C

MODIFICATIONS TO RULES FOR ARBITRATION INVOLVING RETRANSMISSION CONSENT

1. We modify the Rules in several respects as they apply to arbitration over retransmission consent.

2. **Initiation of Arbitration.** Arbitration shall be initiated as provided in Rule R-4 except that, under Rule R-4 (a) (ii) the MVPD shall not be required to submit copies of the arbitration provisions of the contract, but shall instead refer to this Order in the demand for arbitration. Such reference shall be sufficient for the AAA to take jurisdiction

3. **Appointment of the Arbitrator.** Appointment of an arbitrator shall be in accordance with rule E-4 of the Rules. Arbitrators included on the list referred to in rule E-4 (a) of the Rules shall be selected from a panel jointly developed by the American Arbitration Association and the Commission and will be based on the following criteria:

a. The arbitrator shall be a lawyer admitted to the bar of a state of the United States;

b The arbitrator shall have been practicing law for at least 10 years;

c. The arbitrator shall have prior experience in mediating or arbitrating disputes concerning media programming contracts;

d The arbitrator shall have negotiated or have knowledge of the terms of retransmission contracts.

4. **Exchange of Information.** At the request of any party, or at the discretion of the arbitrator, the arbitrator may direct the production of current and previous contracts between either of the parties and MVPDs and broadcast stations as well as any additional information that is considered relevant in determining the value of the programming to the parties. Parties may request that access to information of a commercially sensitive nature be restricted to the arbitrator and outside counsel and experts of the opposing party.

5. **Administrative Fees and Expenses.** If the arbitrator finds that one parties' conduct, during the course of the arbitration, has been unreasonable, the arbitrator may assess all or a portion of the other parties costs and expenses (including reasonable attorneys' fees) against the offending party.

6. **Locale.** In the absence of agreement between the parties, the arbitration shall be held in the city that contains the headquarters of the MVPD.

7. **Form of Award.** The arbitrator shall render a written award containing the arbitrator's findings of fact and reasons supporting the award. If the award contains confidential information, the arbitrator shall compile two versions of the award; one containing the confidential information and one with such information redacted. The version of the award containing the confidential information shall only be disclosed to persons bound by the Protective Order issued in connection with the arbitration. The parties shall include such confidential version in the record of any review of the arbitrator's decision by the Commission.

APPENDIX D

TECHNICAL APPENDIX

I. STAFF ANALYSIS OF THE LIKELIHOOD OF FORECLOSURE IN THE BROADCAST TELEVISION PROGRAMMING MARKET

1. The two primary scenarios of competitive harm that have been alleged are: (1) permanent foreclosure, where the broadcast signal is permanently removed from rival MVPDs and (2) temporary foreclosure, where the broadcast signal is removed for a brief period, possibly during the negotiations for retransmission consent. We first analyze the allegations that following the transaction Applicants will have an incentive to permanently withhold consent to retransmit the local broadcast signal from rival MVPDs. While Cablevision and JCC believe that temporary foreclosure is much more likely in this situation,[1] other commenters argue that permanent foreclosure is also a legitimate concern.[2] Our analysis is similar for both forms of the alleged harm. We determine the number of consumers that must switch to DirecTV to compensate News Corp. for the loss in revenue that occurs when the signal is removed from rival MVPDs. We refer to this as the critical value. If more than this number of customers are likely to switch to DirecTV following the withdrawal of the local broadcast signal, then News Corp. would find it profitable to withhold the local broadcast signal from a rival MVPD.

A. Permanent Withdrawal of the Broadcast Signal from Rival MVPDs

2. Concerned parties in this proceeding have alleged that the transaction will give News Corp. an increased incentive and ability to profitably withhold consent to retransmit broadcast television signals from rival MVPDs.[3] Applicants argue that permanently withholding the right to retransmit the signals of News Corp. owned and operated ("O&O") broadcast television stations would not be profitable given the likely reactions of consumers.[4] Applicants estimate that DirecTV would need to increase its market share from 13% to between 44% and 53%, depending on the assumptions used.[5] We analyze the incentives to engage in permanent withdrawal of the broadcast signal from rival MVPDs weighing the arguments of the parties over the various methods and assumptions used in the analysis.[6] In addition to analyzing the incentives to withhold the signals of News Corp.'s owned and operated stations, we analyze the incentives to withhold the local broadcast signals of independently owned affiliates. We perform this calculation because evidence in the record indicates that **[REDACTED]**.[7] We begin with determining the loss News Corp. will suffer if it permanently removes its local broadcast signal from rival MVPDs. If News Corp. removes its signal from rival MVPDs it stands to lose the

[1] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 15; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 6.

[2] EchoStar Petition at 14-15; ACA Comments at 10-11.

[3] *Id.*

[4] Applicants' Reply at 39.

[5] Applicant's Reply, CRA Analysis, ¶ 71 and ¶ 73.

[6] Many of the values used in analyzing the situation of temporary withdrawal are also used in analyzing a situation of permanent withdrawal, we will discuss some of the values proposed by the parties for use in the analysis of temporary withdrawal as they arise in our analysis of permanent withdrawal.

[7] **[REDACTED]**.

DirecTV in its planning processes,[15] and Cablevision offers a range of between 5% and 10% with a stated preference for using News Corp.'s weighted average cost of capital of 8%.[16]

4. We find that the use of the hurdle rate would be an inappropriate value to use for discounting cash flows. The hurdle rate is "the rate of interest in a capital budgeting study that a proposed project must exceed before it can be regarded as worthy of consideration."[17] "The hurdle rate is often based on the cost of capital or the weighted average cost of capital, adjusted by a factor to represent the risk characteristics of the projects under consideration."[18] We prefer to use a more objective measure of the opportunity cost of capital to the firm such as the weighted average cost of capital.[19] However, we note that News Corp.'s weighted average cost of capital is unusually low when compared with MVPDs.[20] We will use 10% as our discount rate, this is a reasonable compromise between News Corp.'s weighted average cost of capital, which does not include the impact of MVPD operations, and the weighted average cost of capital of firms in the MVPD industry.

5. The previous discussion focused on determining the profit margin on customers serviced by DirecTV. However, not all customers receiving DirecTV services are serviced by DirecTV; some are serviced by the National Rural Telecommunications Cooperative (NRTC). Some of the customers that shift to DirecTV service in the event of a permanent withdrawal of a broadcast station signal will be serviced by NRTC rather than DirecTV. DirecTV earns a substantially lower margin on these customers. Applicants estimate that this value is less than **[REDACTED]** per NRTC subscriber per month.[21] Absent any further data, we will use this value as the profit margin on DirecTV customers serviced by NRTC in our analysis. We will assume that the customers switching to DirecTV after a permanent withdrawal will be serviced by DirecTV and NRTC in the same proportion as existing customers in the DMA.

6. Before performing the calculation we must identify reasonable values for the share of rival MVPD customers that will use over-the-air reception to obtain the broadcast signal. Applicants, in their analysis, use the figure of 33%.[22] Cablevision assumes values of 33% and 50% and JCC use the

[15] *Id*

[16] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 13. Estimates of Fox Entertainment Group's weighted average cost of capital range between 8.8% and 9.7%. JP Morgan Securities, *Media & Entertainment: December 2002Quarterly Review and Outlook*, Feb. 24, 2003 at 28; Bank of America Securities, *Entertainment Industry Overview*, July 2003 at 163.

[17] *A Dictionary of Finance and Banking 2nd Edition*, Oxford University Press, 1997 at 167.

[18] *Id*

[19] "The WACC is a company cost of capital. Strictly speaking, it works only for projects that are carbon copies of the firm's existing assets, in both business risk and financing. Often it is used as a companywide benchmark discount rate; the benchmark is adjusted upward for unusually risky projects and downward for unusually safe ones." Richard A. Brealey and Stewart C Myers, *Principles of Corporate Finance, 5th Edition,* McGraw-Hill, 1996 at 523.

[20] See for example Morgan Stanley, *The Copernicus Theorem*, July 2, 2003 which reports weighted average costs of capital for the major firms in the MVPD industry ranging from 10.0% to 11.25%.

[21] Applicants' Reply, CRA Analysis at fn. 39.

[22] Applicants' Reply, CRA Analysis ¶ 73.

foreclosure. We find this analysis incomplete and suffering from the "fallacy of division."[32] Accordingly, we will calculate the critical values that would make permanent foreclosure of broadcast station's programming at the smallest geographic level possible. Ideally that would be at the level of a cable franchise within a Nielsen Designated Market Area ("DMA"). However, we do not have reliable figures on cable subscribers by franchise in a DMA. We do have estimates of the cable and DirecTV households in a DMA.[33] Therefore we perform our calculations at the DMA level and assume that the programming is withdrawn from all competing MVPDs within the DMA. We find this a reasonable assumption and a feasible strategy since **[REDACTED]**.[34]

9. Our analysis of the incentives for News Corp. to permanently withhold retransmission consent of broadcast signals from rival MVPDs indicates that this strategy is unlikely to be profitable to News Corp. and its affiliates. If News Corp. could claim 50% of joint profits of a withdrawal strategy, it would find a withdrawal of the local broadcast station from rival MVPDs to be profitable if, depending on the broadcast station, between **[REDACTED]** and **[REDACTED]** of cable customers switched to a DBS provider. If News Corp receives 100% of the joint profits from the strategy, the percentage of rival MVPD customers that must switch to make temporary foreclosure profitable is between **[REDACTED]** and **[REDACTED]** for the various local broadcast stations. Table A-1 presents the percentage of all rival MVPD subscribers that reside in areas where News Corp. would find it profitable to permanently withdraw the local broadcast signal. This value will depend on the percent of rival MVPD subscribers that shift in response to the removal of the local broadcast station from their chosen MVPD. We hypothesize a range of values from **[REDACTED]** to **[REDACTED]**. If we can expect **[REDACTED]** of rival MVPD customers to defect to DirecTV following a withdrawal of the broadcast station, News Corp. would find the withdrawal a profitable endeavor against companies serving **[REDACTED]** of all rival MVPD subscribers if News Corp. can lay claim to 50% of the additional joint profits. If News Corp. gains 100% of the additional joint profits, **[REDACTED]** of all rival MVPD subscribers would be at risk from suffering under a permanent withdrawal of the programming.

10. Table A-1. Percentage of Rival MVPD Subscribers at Risk of a Permanent Withdrawal of their Local Broadcast Signal.**[REDACTED]**

B. Temporary Withdrawal of the Broadcast Signal from Rival MVPDs

11. Commenters raise the concern that the more likely harm to rivals will occur from the temporary withdrawal of the broadcast signal from rival MVPDs, rather than permanent withdrawal. Cablevision estimates that DirecTV need only add between 0.7 and 1.4 points to its market share for temporary withholding of the broadcast signal to be profitable.[35] Applicants argue that using more

[32] The "fallacy of division" occurs when one argues that what is true for the whole is also true for the parts. In this context, News Corp. argues that since it would not be profitable to permanently withhold retransmission consent of all of its owned and operated stations, it would also be true that it is not profitable to withhold consent for any single station.

[33] DirecTV July 30, 2003 Response **[REDACTED]**; BIA MasterAccess Database of Television Stations. We assume that the number of subscribers to EchoStar is proportional to DirecTV's share in the DMA in the same proportion as the two firms' market shares nationally.

[34] News Corp July 28, 2003 Response **[REDACTED]**.

[35] Cablevision Sept 25 Ex Parte, Rubinfeld Analysis II at 13.

customers that switch to DirecTV agree to purchase twelve months of programming.[41] After that period of time, a number will return to their previous MVPD. Applicants report that **[REDACTED]** of new DirecTV customers drop service over the course of one year.[42] They believe that a larger fraction of the customers induced to switch because of the temporary withholding will leave and consequently assume that **[REDACTED]** customers will leave after the first year.[43] Following the initial churn of these new customers, Applicants assume that these new customers will exit at DirecTV's average churn rate of **[REDACTED]** per month.[44] Cablevision and JCC argue that customers who switched to DirecTV due to the temporary withdrawal are, if anything, less likely to churn than the average DirecTV customer.[45] We assume this initial churn rate is **[REDACTED]**, which is **[REDACTED]** the normal 12 month churn rate of DirecTV. We base this value on the regression analysis described later in this appendix where we analyze the impact on DirecTV customer disconnects of the introduction of the YES cable network on Cablevision cable systems in New York, which signaled the return of New York Yankees baseball games to those systems. Our analysis also indicates that **[REDACTED]**. Therefore, following the initial churn of these new customers, we assume that the continuing churn rate of these new customers will be equal to **[REDACTED]** per month.

14. Cablevision suggests that an additional adjustment should be made to account for the positive impact the temporary foreclosure would have on the future growth rate of DirecTV.[46] We reject this proposed adjustment. In Section I.C of this appendix we examine the effects of the temporary withdrawal of a local broadcast station signal from one of DirecTV's competitors and **[REDACTED]**.

15. With these assumptions, as well as those discussed in analyzing the impact of permanent withholding of the local broadcast station's signal, the losses and gains from a temporary foreclosure can be calculated. Applicants, as well as Cablevision, propose that the calculation for the withholding of retransmission rights for a local broadcast station be based upon a one month withholding.[47] We will adopt this assumption as well. In the first period News Corp. will suffer the loss of a month's worth of advertising revenue. In the succeeding month, the temporary foreclosure will have ended and News Corp. will no longer suffer the loss associated with it and is assumed to earn the same advertising revenue and compensation from retransmission consent as it did prior to the withholding. The gain experienced by News Corp. will be its share of the profit margin from each new customer that arrives from a rival MVPD. News Corp. also will be assessed its share of the one-time subscriber acquisition costs associated with each new subscriber. For 11 successive months, News Corp. will earn its share of the profit margin on the customers that shifted due to the temporary foreclosure. It continues to receive these profits because these customers, in order to receive free installation and equipment, have committed to purchase 12 months of DirecTV programming. However, in the thirteenth month, when the new customers' commitments expire, DirecTV will lose **[REDACTED]** of the customers it acquired

[41] DirecTV July 30, 2003 Response **[REDACTED]**

[42] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 15

[43] *Id*

[44] *Id*

[45] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 14; Cablevision Sept. 25 Ex Parte, Rubinfeld Analysis II at 9.

[46] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 14.

[47] Applicants' Sept 8 Ex Parte, CRA Analysis II ¶ 23; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 6.

Applicants argue that the situation in Houston is not relevant since it involved a case of a cable company removing the broadcast signal from its system rather than a broadcaster withholding the signal from a cable company.[50] We disagree with the Applicant's position. The value of the Houston incident is not in determining which firm found it more advantageous to carry through on the removal or withholding of the signal. The value is in analyzing how Time Warner customers reacted when the signal was no longer available on the cable system. To that extent, Applicants have not convinced us that the specific details in Houston bias estimates of consumer reactions to the withdrawal of a broadcast signal from a cable system.

19. We approach the problem from the standpoint of researchers estimating the impact of a policy. We obtain data from two separate groups A control group which is unaffected by the policy for the entire period under observation, and a treatment group, that for some period of time has the policy applied to them. In the case at hand, the policy or treatment is the removal of the ABC affiliate from the Time Warner cable system. Our treatment group consists of those ZIP codes within the Houston DMA that where Time Warner offers service to at least 75% of the households. For our control group we use those ZIP codes within the Houston DMA where Classic Cable or Northwoods Cable offer service to at least 75% of the households.[51] Both firms in the control group carried the ABC affiliate on an uninterrupted basis during 2000. We measure the effect of these events on the growth rate in DirecTV subscribers for each month between December 1999 and July 2000.

20. We use an econometric method known as "fixed effects estimation."[52] This method estimates DirecTV's subscriber growth rate in a ZIP code as depending on a ZIP code-specific effect, which varies across ZIP codes, but does not vary over time, and a time-specific effect which varies over time, but is the same across all ZIP codes. The treatment effect is measured by indicator variables for the Time Warner ZIP codes for each month between December of 1999 and July of 2000. These indicator variables will measure the difference between DirecTV's growth in Time Warner ZIP codes and in the Classic and Northwoods ZIP codes after accounting for the factors that are due either to constant characteristics of the ZIP code, such as household income, population density, and consumer preferences, or effects at one point in time that affect both sets of ZIP codes equally, such as changes in DirecTV programming.

21. The estimated monthly difference in DirecTV's growth rate in areas served by Time Warner as compared to the control group that was not in a retransmission consent dispute is given in table A-3. The results indicate a statistically significant increase in the growth rate of DirecTV in the ZIP codes where consumers were continually being told that they were likely to be losing access to the ABC affiliate on the incumbent cable operator.[53]

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[50] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 21-22.

[51] To make a determination of which ZIP codes and the fraction of households that fall within the service areas of the firms we use the May 2003 GDT Dynamap 2000 ZIP code boundaries, 3rd Quarter 2002 incumbent cable operator service territories from MediaPrints™, ©Warren Communications News Inc. and The Janus Group, and 2000 Census Summary File 1.

[52] See Jeffrey Wooldridge, *Econometric Analysis of Cross Section and Panel Data*, The MIT Press, 2002, Chapter 10.

[53] See for example, Mike McDaniel, *Picture Looking Dark in TV Feud, Channel 13 May Go Off Cable Tonight*, HOUSTON CHRONICLE, March 9, 2000.

permanent withholding of a broadcast station, indicates that for the strategy to be profitable DirecTV's market share must increase between 93% and 128%.[56]

28. News Corp. has provided the affiliation revenue and subscriber counts of each MVPD distributing a RSN it manages, as well as the aggregate advertising revenues for each network.[57] From these data we calculate the average advertising revenue per subscriber for each RSN. We also calculate the average revenue per subscriber for each RSN carried by each MVPD. In association with subscriber counts, these are the costs of removing a RSN from a rival MVPD.

29. A portion of the benefits of removing a RSN from a rival MVPD are the additional profits that accrue from those customers that switch to DirecTV service. We use the same value we used when calculating the critical values for the withholding of a broadcast station signal. News Corp. also receives the RSN affiliate fees and advertising revenue the switching customers generate. We make one significant modification from the analysis of permanent withholding of broadcast station signals. We assume that the RSN is withdrawn from the competing cable company, but not from EchoStar. We make this assumption because **[REDACTED]**.[58] The effect of this assumption is to reduce the number of cable subscribers defecting to DirecTV following the withdrawal of the RSN from the rival cable provider. Since EchoStar also carries the RSNs, some of the defecting cable subscribers will choose to purchase service from EchoStar rather than DirecTV. News Corp. will not share in any of the additional profit EchoStar earns from those customers, but it will receive advertising revenues as well as affiliate fees. We assume that switching cable subscribers go to the two DBS companies in the same proportion as the firms' national market shares, 42% will go to EchoStar and 58% will go to DirecTV.[59] As in the previous analysis, we calculate the critical values for situations where News Corp. can lay claim to 50% and 100% of the joint profits generated by the withdrawal of the RSN.[60]

30. We calculate a critical value for each of **[REDACTED]** cable systems carrying a RSN owned and managed by News Corp.[61] This allows us to replicate the pattern of previous withdrawals and **[REDACTED]**, as well as address ACA's claims that small cable companies are particularly vulnerable to this tactic.[62] We do not calculate a critical value for any RSNs carried by EchoStar

[56] Applicants' Reply, CRA Analysis at 51

[57] News Corp. July 28, 2003 Response **[REDACTED]**.

[58] See News Corp. July 28, 2003 Response **[REDACTED]**.

[59] Applicants' Reply, CRA Analysis ¶ 32.

[60] The critical value is

$$\left[\frac{(Ad\,Revenue + CableAffiliateFee) \bullet (RivalCableSubs)}{\alpha \bullet (s \bullet (DTV\,Profits) + DTVAffiliateFee) + (1-\alpha) \bullet EchoAffiliateFee + Ad\,Revenue}\right], \text{ where}$$

's' represents the share of the joint profits that will accrue to News Corp. and 'α' is the fraction of subscribers leaving cable that shift to DirecTV.

[61] We do not perform this calculation for Fox Sports Net Rocky Mountain because it has only recently merged with Fox Sports Net Utah and the exact status of carriage and revenue amounts are unclear.

[62] ACA Comments at 18

of a RSN, we do not have adequate data to allow us to analyze the likelihood of a temporary withdrawal of a RSN from EchoStar, **[REDACTED]**.

35. Applicants' in their calculations assume that the withdrawal of the RSN lasts for three months, after which time it is returned to the rival MVPD.[66] JCC suggests that a more appropriate assumption would be a one month withdrawal, the same period as Applicants and Cablevision use to analyze the profitability of withdrawal of a broadcast television station signal.[67] As with the temporary foreclosure analysis of the local broadcast station market, we will assume that the foreclosure lasts for one month, during which time a fraction of the MSO's subscribers will shift to a DBS provider carrying the RSN. We assume that switching cable subscribers go to the two DBS companies in the same proportion as their national market shares, 42% will go to EchoStar and 58% will go to DirecTV.[68] We will also assume that the rate at which customers return to their original MVPD is the same regardless which DBS firm they moved to. The pattern will match that of our local broadcast station analysis in that no customers will leave the DBS firms for the first 12 months following the temporary foreclosure, **[REDACTED]** will leave once their contracts expire, and in all following months, **[REDACTED]** of the remaining customers will return to their original MVPDs.

36. Under this scenario, the cost to News Corp. of the temporary foreclosure in the first month is the foregone affiliate fees from the cable company for the first month, as well as the advertising revenues those subscribers would have generated. In subsequent months, News Corp. will continue to lose a fraction of the affiliate fees and advertising revenue from the cable provider since a portion of the cable subscriber base will have switched to EchoStar and DirecTV, although over time as subscribers shift back to cable, this loss diminishes. The gain to News Corp. in the first month consists of its share of DirecTV's profit margin minus the subscriber acquisition cost. It receives this gain from the 58% of defecting cable subscribers that choose to switch to DirecTV. It also receives affiliate fees and advertising revenue from DirecTV and EchoStar for the fractions of defecting subscribers that switch to those services. In the second through twelfth months, News Corp. receives its share of DirecTV's additional profits as well as the RSN affiliate fees and advertising revenues from the DBS providers. In the thirteenth month, **[REDACTED]** of the former cable customers that switched to DirecTV and EchoStar will return to the cable MSO. In each subsequent month, EchoStar and DirecTV will lose **[REDACTED]** of the remaining customers. These flows of costs and benefits are discounted in the same manner as in our analysis of the broadcast station segment.

37. Our analysis of the incentives for News Corp. to engage in a strategy of temporary foreclosure against any of the **[REDACTED]** MSOs carrying a News Corp.-managed RSN indicates that there is a strong possibility that this type of behavior can be profitable following the transaction. If News Corp. could claim 50% of the additional joint profits, it would find a one month temporary withdrawal of the RSN to be profitable if, depending on the RSN and cable operator, between **[REDACTED]** and **[REDACTED]** of cable customers switched to a DBS provider. If News Corp. can lay claim to 100% of the additional joint profits, the percentage of cable customers that must switch to make temporary foreclosure profitable is between **[REDACTED]** and **[REDACTED]** for the various cable operators and RSNs. Table A-5 presents the percentage of rival cable subscribers that reside in areas where News Corp. would find it profitable to temporarily withhold its RSN. This value depends

[66] *Id.*

[67] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 10.

[68] Applicants' Reply, CRA Analysis ¶ 32.

loss of New York Yankees games, as well as other professional sports teams, was on the order of 30,000 customers.[75] However no party conducted a thorough examination of the effect of this episode on the numbers of DirecTV subscribers, while accounting for pre-existing patterns of subscriber shifts which are naturally occurring in the MVPD marketplace.[76]

42. We approach the problem in the same fashion as we estimated the impact of the warnings and ultimate withdrawal of the ABC affiliate in Houston. We obtain data from two separate groups. A control group which is unaffected by the policy for the entire period under observation, and a treatment group, that for some period of time has the policy applied to them. The policy or treatment is the removal of Yankees and Nets games from the cable system. Our treatment group consists of those ZIP codes within the New York DMA that are wholly served by Cablevision. For our control group we use those ZIP codes within the New York DMA that are wholly served by Time Warner, which had reached an agreement to carry the YES network.[77] We measure the effect of these events on the growth rate in DirecTV subscribers for each month between January 2001 and June 2003.

43. Table A-6 presents the estimated treatment effects for each month since January 2002. The values represent the additional percentage growth in subscribers above what would have been predicted to occur had Cablevision been carrying the YES network. The pattern is growth rates follows what we might reasonably expect to see happen. **[REDACTED]**.

44. Table A-6. Additional DirecTV Subscriber Growth in New York due to YES Dispute with Cablevision. **[REDACTED]**

45. We can calculate the short-term impact of the withdrawal of New York Yankees games by applying the excess growth rates **[REDACTED]**.[78] **[REDACTED]**.[79] Therefore we estimate that the withdrawal of Yankees games during April of 2002 cost Cablevision **[REDACTED]** of its customer base. If we assume that a similar shift away from Cablevision would occur if both competitors, EchoStar and DirecTV, carried the desired programming but Cablevision did not, our results indicate that DirecTV would capture **[REDACTED]** of Cablevision's customers and EchoStar would capture **[REDACTED]** during a one month withdrawal of programming. Over the entire one-year course of the dispute, our analysis predicts that DirecTV gained an additional **[REDACTED]** subscribers due to the absence of the YES network on Cablevision and EchoStar. This equates to an increase of **[REDACTED]** of DirecTV customers and a loss of **[REDACTED]** to Cablevision.

[75] Some press reports put this figure as high as 39,400. See for example Erin McClam, *Opening Day Deal for Cablevision, YES Network*, Associated Press, April 1, 2003.

[76] EchoStar did perform an analysis of its loss in customers due to its lack of the YES network. However, the additional incentive to engage in temporary foreclosure that this transaction creates is derived from the customers that shift to DirecTV. EchoStar's analysis only examines an unknown fraction of that shift EchoStar Dec. 15 Ex Parte, Exhibit 1.

[77] To make a determination of which ZIP codes fall within the service areas of the two firms we use the May 2003 GDT Dynamap 2000 ZIP code boundaries and the 3rd Quarter 2002 incumbent cable operator service territories from MediaPrints™

[78] This estimate is based upon DirecTV July 30, 2003 Response **[REDACTED]** as well as GDT ZIP code boundaries and MediaPrints™ cable system boundaries.

[79] CSC HOLDINGS INC 8-k, May 15, 2003.

46. Applicants have argued that the maximum shift from Cablevision to DirecTV was on the order of 30,000 subscribers for the entire one year period. We reject that estimate for a number of reasons. First and foremost, we have no information on how this value was generated and what factors it takes into account. Cablevision's SEC reports indicate that between December 2000 and December 2001 the percentage of homes served rose from 68.0% to 69.4%. However, by the end of March 2002, this penetration rate had fallen to 69.1% of homes passed. This decline continued through March 2003, when it reached a low of 67.5%. The most recent figures, for June of 2003, indicate that this trend has been reversed, with the penetration rate rising to 67.6%. Cablevision passes slightly more than 4 million homes in the New York area, so each point of penetration corresponds to approximately 40,000 customers. This naive analysis would indicate that Cablevision may have lost 64,000 customers over the course of the year in which it did not carry YES. Cablevision's own data indicate a substantial loss in customers, a loss in excess of the 30,000 claimed by Applicants.

47. We also need to assess the extent to which the return of withdrawn programming to an MVPD provider influences the behavior of consumers. Applicants argue that once the temporarily withdrawn programming has returned to an MVPD those households that switched to DirecTV are more likely to leave DirecTV and return to their previous service providers.[80] Other parties however argue that those customers that switched may be less likely to move back for a number of reasons, including a concern that the programming may be withdrawn again.[81] Using the same technique as we did to examine the shift in consumers, we can examine the churn, or disconnect, rate of DirecTV subscribers in Time Warner and Cablevision service areas of the New York DMA. Our previous regression results indicate that **[REDACTED]**. Estimating exactly the same regression specification with the exception of using the percentage of customers disconnecting in a month as the dependent variable, we find **[REDACTED]**. We would have expected the monthly disconnect rate in Cablevision ZIP codes to have been **[REDACTED]**. Therefore, we will assume that the disconnect rate is **[REDACTED]** that for other DirecTV customers in the time period when the DirecTV contracts expire for those customers who shifted due to the temporary withdrawal. Applicants report that **[REDACTED]** of customers drop DirecTV service after 1 year, so we estimate that **[REDACTED]** of customers induced to switch to DirecTV during a temporary withdrawal will drop DirecTV service once their contract expires.

[80] Applicants' Sept 8 Ex Parte, CRA Analysis II ¶ 12

[81] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 17, Cablevision Sept. 25 Ex Parte, Rubinfeld Analysis II at 9.

on the percent of subscribers to cable companies that shift in response to the one month withdrawal of the RSN. We examine the extent of the profitability of temporary withholding for a range of values of the consumer response. If **[REDACTED]** of cable customers defect to DirecTV following a withdrawal of the RSN, News Corp. would find the withdrawal profitable in areas with **[REDACTED]** of RSN cable subscribers if News Corp. can lay claim to 50% of the joint profits. If News Corp. gains 100% of the joint profits, **[REDACTED]** of RSN cable subscribers are at risk from suffering under a temporary withdrawal of the programming.

38. Table A-5. Percentage of Cable Subscribers at Risk of a Temporary Withdrawal of Regional Sports Programming.**[REDACTED]**

C. Estimation of the Impact on DirecTV of the Withdrawal of Regional Sports Networks from Rival MVPDs

39. Parties in this proceeding have alleged that News Corp., once the transaction has been completed, will have an incentive to engage in temporary foreclosure as a strategy to increase rates for the Fox-managed RSNs, as well as shift subscribers from rival MVPDs to DirecTV. At the heart of these claims are suppositions about how consumers react when a RSN is removed from one MVPD, but remains available on other MVPDs. We estimate the actual shifts in subscribers that occurred during periods when the Yankees Entertainment and Sports Network (YES) was unavailable to subscribers of the Cablevision cable system and the EchoStar DBS service, but was available to DirecTV subscribers.

40. On March 19, 2002 the YES network was launched as a regional sports network in the New York area. At the time of launch, the network had agreements with several professional sports teams, as well as an assortment of local high school and college sporting events. At launch, the network carried New York Yankees baseball games.[69] In November of 2002 New Jersey Nets basketball games became available.[70] These teams had previously been available on competing RSNs which were carried by many local cable companies and both DBS providers.[71] Prior to launch, YES network reached affiliate agreements with 35 cable companies as well as DirecTV.[72] It did not reach an agreement with either Cablevision or EchoStar. On March 31, 2003, approximately 25 minutes prior to the start of the first Yankees game of the season, Cablevision and YES reached an interim agreement for carriage.[73] EchoStar still does not carry the YES network.

41. This episode of availability, followed by withdrawal, followed by availability exhibits the pattern of temporary foreclosure proposed by some parties in this proceeding. Several parties have argued that this episode can provide a prime example of the likely shifts in MVPD subscribers when faced with a temporary withdrawal of a RSN.[74] Applicants argue that the impact on Cablevision of the

[69] Christopher Schultz, *The Starting Lineup*, Cable World, March 18, 2002.

[70] Steve Zipay, *Nets Latest Victim of Cablevision Greed*, Newsday, November 13, 2002.

[71] Erin McClam, *Opening Day Deal for Cablevision, YES Network,* Associated Press, April 1, 2003.

[72] *Id*

[73] *Id*

[74] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 16; Applicants' Sept. 8 Ex Parte, CRA Analysis II at 10-11; Letter from Pantelis Michalopoulos, Steptoe and Johnson, L.L.P., to Marlene H. Dortch, Secretary, FCC (Dec. 15, 2003) ("EchoStar Dec. 15 Ex Parte") at 4-5.

because we do not possess sufficient information about the locations and market shares of the cable systems that carry and do not carry the relevant RSNs to make precise calculations regarding News Corp.'s incentives to withhold programming. However, to the extent that DirecTV and EchoStar are much closer substitutes, News Corp. would have an even greater incentive to withhold programming from EchoStar since a larger fraction of EchoStar's customers would be likely to shift to DirecTV than to cable.

31. The analysis of the incentives for News Corp. to permanently withhold regional sports networks from rival MVPDs indicates that this is unlikely to be a profitable endeavor for News Corp. If News Corp. could claim 50% of the joint profits from a withdrawal strategy, it would find permanently withholding a RSN from a rival MVPD to be profitable if between **[REDACTED]** and **[REDACTED]** of cable customers switched to a DBS provider. If News Corp. receives 100% of the joint profits from the strategy, the percentage of the rival MVPD's customers that must switch to make permanent foreclosure profitable is between **[REDACTED]** and **[REDACTED]**. Table A-4 presents the percentage of all rival cable subscribers that reside in areas where News Corp. would find it profitable to permanently withdraw its RSN. This value will depend on the percent of rival cable subscribers that shift to DBS in response to the removal of the local broadcast station from their chosen MVPD. We hypothesize a range of values from **[REDACTED]** to **[REDACTED]**. If we can expect **[REDACTED]** of rival cable customers to defect to DBS following a withdrawal of the RSN, News Corp. **[REDACTED]** when they can lay claim to 50% of the additional joint profits. If News Corp. gains 100% of the additional joint profits, **[REDACTED]** of all rival cable subscribers would be at risk from suffering under a permanent withdrawal of the programming.

32. Table A-4. Percentage of Cable Subscribers at Risk of a Permanent Withdrawal of Regional Sports Programming.**[REDACTED]**

B. Temporary Withdrawal of Regional Sports Networks from Rival MVPDs

33 JCC argue that the more likely harm is from temporary withdrawal of an RSN during pricing disputes as a tactic to negotiate higher affiliate fees, rather than the threat to permanently withdraw the RSN.[63] They estimate that as few as **[REDACTED]** of cable subscribers must shift to DirecTV for a strategy of temporary withholding to be a credible threat in affiliate fee negotiations.[64] Applicants instead contend that at least **[REDACTED]** of cable subscribers must shift to DirecTV for News Corp. to earn a profit by temporarily withholding a RSN.[65]

34. The analysis of temporary foreclosure of RSNs by News Corp. takes a slightly different tack than the analysis of temporary foreclosure of the local broadcast stations' signals. In that analysis, the losses and gains of foreclosure were based on advertising revenue, which were the same regardless of which MVPD in a DMA was the rival. With RSNs, the losses from foreclosure also depend upon the affiliate fees, and those vary across MVPDs. Therefore we will analyze a temporary foreclosure situation assuming that News Corp. removes an RSN from a specific MSO, but not from EchoStar. Again, we analyze this scenario because **[REDACTED]**. As with our analysis of permanent foreclosure

[63] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 2.

[64] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 11.

[65] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 16.

22. Table A-3. Additional DirecTV Subscriber Growth in Houston due to Retransmission Consent Dispute between ABC and Time Warner. **[REDACTED]**

23. We can calculate the impact of the warnings and actual withdrawal of the ABC affiliate from Time Warner cable systems in Houston by applying the excess growth rates **[REDACTED]**.[54] **[REDACTED]** Therefore, we estimate that the effect on DirecTV of the withdrawal of broadcast programming from the rival cable operator was an additional **[REDACTED]** subscribers. We estimate that because of the 39-hour withdrawal of the ABC affiliate Time Warner lost **[REDACTED]** of its customer base to DirecTV. If we assume that EchoStar gained customers at a rate equivalent to its market share relative to DirecTV, Time Warner would have lost a further **[REDACTED]** of its customer base to EchoStar.

24. We would like to verify our assumptions about the churn rate of DirecTV customers following the return of the signal, but are unable to do so, because the churn resulting from this incident would not evidence itself until 2001 when the 1-year contracts signed by consumers expired. The data submitted by DirecTV exhibits a discontinuity between 2000 and 2001 due to the acquisition and conversion of PrimeStar customers. Consequently, we must rely on our analysis of churn following the return of withdrawn regional sports programming.

II. STAFF ANALYSIS OF THE LIKELIHOOD OF FORECLOSURE IN THE REGIONAL SPORTS NETWORK MARKET

25. The analysis of the incentive and ability of News Corp. to withhold carriage of regional sports networks (RSNs) from DirecTV's competitors in the MVPD market closely follows the methods used in the analysis of the same issue in the local broadcast programming market. We calculate the number of consumers that must switch to DirecTV to compensate for the loss in revenue when a cable system no longer carries the RSN. As with our analysis of the withholding of broadcast television station signals, we consider cases of permanent and temporary withholding.

A. Permanent Withdrawal of the Regional Sports Network from Rival MVPDs

26. The case of permanent foreclosure differs slightly from that examined in the local broadcast station segment since RSN programming is generally not available over the air. If News Corp. removes its RSN from a rival MVPD it loses the advertising revenues associated with all of those subscribers, not just a fraction as was the case with the local broadcast station. In addition to a loss in advertising revenue, there is also the loss in the affiliate fees paid by the rival MVPD for the right to carry the RSN. The gain to News Corp. of a permanent withholding strategy is its share of the joint profits earned from the consumers that switch from the rival MVPD, as well as the affiliate fees and advertising revenues those consumers bring with them.

27. Applicants assert that permanent withholding of a RSN from a rival MVPD is not a rational economic act.[55] Their analysis, using the same method as they employed in analyzing the

[54] This estimate is based upon DirecTV October 24, 2003 Response to the Commission's Second Information and Document Request **[REDACTED]** as well as GDT ZIP code boundaries and MediaPrints™ cable system boundaries

[55] Applicants' Reply at 27-36.

due to the temporary foreclosure. In each continuing month, DirecTV will lose **[REDACTED]** of the remaining customers. Given this monthly pattern of gains and losses, we discount the earnings of future periods using a discount rate of 10%. We calculate the number of rival MVPD customers that must switch to DirecTV for the one month withdrawal to be profitable to News Corp. and DirecTV for each owned and operated broadcast station as well as independently owned affiliates of the Fox Broadcast Network.

16. Our analysis indicates that a temporary withdrawal of local broadcast signals from rival MVPDs is a credible negotiating tactic. It demonstrates that in most areas of the country, following the transaction, News Corp. can earn additional profits based on the consumers that switch to DirecTV when the local broadcast signal is withheld from rival MVPDs. Rival MVPDs facing this situation during retransmission consent negotiations will have two choices, either give News Corp. additional considerations for retransmission consent or have News Corp. earn those additional profits through the mechanism of temporary withholding. If News Corp. could claim 50% of joint profits of a withdrawal strategy, it would find a withdrawal of the local broadcast station's signal from rival MVPDs to be profitable if, depending on the broadcast station, between **[REDACTED]** and **[REDACTED]** of cable customers switched to DirecTV. If News Corp. receives 100% of the joint profits from the strategy, the percentage of rival MVPD customers that must switch to make temporary foreclosure profitable is between **[REDACTED]** and **[REDACTED]** for the various broadcast stations. Table A-2 presents the percentage of rival MVPD subscribers that reside in areas where News Corp. would find it profitable to temporarily withhold the local broadcast signal. This value depends on the percent of subscribers to rival MVPDs that shift in response to the one month withdrawal of the local broadcast station from their MVPD. We examine the extent of the profitability of temporary withholding for a range of values of the consumer response. If **[REDACTED]** of rival MVPD customers defect to DirecTV following a withdrawal of the local broadcast station, News Corp. would find the withdrawal profitable in areas with **[REDACTED]** of rival MVPD subscribers if News Corp. can lay claim to 50% of the joint profits. If News Corp. gains 100% of the joint profits, **[REDACTED]** of rival MVPD subscribers are at risk from suffering under a temporary withdrawal of the programming.

17. Table A-2. Percentage of Rival MVPD Subscribers at Risk of a Temporary Withdrawal of their Local Broadcast Signal.**[REDACTED]**

C. Estimation of the Impact of the Withdrawal of a Broadcast Station from Rival MVPDs on DirecTV

18. The preceding analysis of the incentives to either permanently or temporarily withhold a broadcast signal from a rival MVPD informs us about the necessary responses from consumers to make the hypothesized harms real. Cablevision has analyzed the results of a retransmission consent dispute between Time Warner and the ABC owned and operated broadcast television station in Houston.[48] Based on their early analysis, they believe that as many as 3% of Time Warner's subscribers may have switched to DirecTV. Subsequent econometric analysis led to a refinement in their conclusion. Cablevision argues that DirecTV **[REDACTED]** of MVPD subscribers in the Houston DMA.[49]

[48] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 3-5.

[49] Letter from Tara Corvo, , Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC, to Marlene H. Dortch, Secretary, FCC (Nov. 20, 2003), Daniel L. Rubinfeld and Duncan Cameron, Estimating the Effect on MVPD Subscribership of the May 2000 Withholding of ABC Network Retransmissions from Time Warner Houston Cable Subscribers at 11.

appropriate assumptions, DirecTV would need to increase its market share by **[REDACTED]** points.[36] In our analysis of the incentives to engage in temporary foreclosure, we build upon the assumptions evaluated in our permanent withholding analysis, and examine several new factors.

12. The possibility of temporary foreclosure presents a different risk of competitive harms. Under this strategy, News Corp. would remove its broadcast signal from rival MVPDs for a short period of time, thereby limiting the loss in advertising revenues it incurs. JCC point out that this withdrawal benefits Applicants in two ways.[37] The first benefit is the same as that analyzed under the hypothesis of permanent foreclosure where the additional customers switching to DirecTV generate profits that accrue to DirecTV and are shared with News Corp. The second benefit accrues solely to News Corp. That benefit is the increased compensation for retransmission consent that News Corp. will be able to extract from MVPDs due to the reduction in the costs of withholding retransmission consent and the greater credibility that the threat of withholding carries. Our analysis of the incentives to temporarily foreclose the local broadcast signals from rival MVPDs is only able to measure the effect of the first benefit, the additional profits that are earned when consumers switch to DirecTV. The effect of the increased credibility of withholding of retransmission on the compensation for retransmission of the local broadcast station's signal is difficult to quantify. As JCC point out, the effect of this increased credibility can have a substantial effect on compensation, even when the profits that accrue from switching subscribers cannot compensate for the advertising revenues lost due to foreclosure.[38] However, the extent of the effect depends on the relative strengths of the bargaining positions of News Corp. and MVPDs. There is no evidence in the record regarding the relative strengths of News Corp. and MVPDs in this area, therefore we are unable to estimate the full magnitude of the increase in the incentive and ability to obtain additional compensation in return for granting retransmission consent. Our analysis will provide an estimate of increased incentive and ability that is likely to occur due to the additional profit News Corp. earns when consumers switch from rival MVPDs to DirecTV, as such it is an estimate of the *minimum* increase in incentive and ability to obtain additional compensation from MVPDs.

13. Unlike the case of permanent foreclosure, with temporary foreclosure, the timing of the various effects becomes important. Because some of the consumers that switch to DirecTV will return to their previous MVPD after the period of withdrawal, we must account for the timing of the subscriber acquisition costs as well as the timing of consumers' return to their original MVPD. We adopt a discounted cash flow approach to allow us to compare these benefits and costs over time.[39] DirecTV requires that customers agree to purchase 12 months of programming before DirecTV will provide free or subsidized equipment and installation.[40] Because **[REDACTED]**, we assume that all of the

[36] Applicants' Sept 8 Ex Parte, CRA Analysis II ¶ 24

[37] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 2.

[38] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 7-9.

[39] The discounted cash flow analysis is the method used by both Cablevision (Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis) and Applicants (Applicants' Sept. 8 Ex Parte, CRA Analysis II) when examining the incentives to engage in temporary withholding of programming. It is the standard method for comparing flows of costs and benefits that vary over time. See for example Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance, 5th Edition*, McGraw-Hill, 1996, Chapter 3.

[40] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 12

complete range of possible values.[23] No one has presented any evidence to indicate what an appropriate value should be. We will use a value of 33%, since in our judgment it is a reasonable approximation, being twice the fraction of television households that currently receive video programming only via broadcast reception.[24]

7. We also need to determine the allocation of the additional profits that would be generated by the withholding of programming. Applicants have suggested the use of two different figures: 34%, representing the fraction of Hughes Electronics that would be acquired by News Corp. pursuant to the transaction documents as well as 50%, representing the fraction of Hughes that News Corp. is permitted to acquire without further approval by Hughes stockholders.[25] Cablevision and JCC argue that a value of 100% is more appropriate and would be consistent with joint profit maximization.[26] News Corp. counters that there are strong checks on News Corp.'s ability to engage in self-dealing, including an independent audit committee.[27] Cablevision and JCC argue that the harms being analyzed result from the joint profit maximizing behavior of both firms and that "News Corp. and DirecTV would simply strike a bargain that maximized their joint profits and then distribute the gains so that everyone would be better off."[28] We reject the 34% value since the new Hughes certificate of incorporation allows News Corp. to acquire up to 50% ownership without further approval by Hughes stockholders.[29] We instead analyze the transaction's effects assuming a 50% division of the additional joint profits earned through the withdrawal of programming, as well as 100%. We analyze the worst-case scenario where News Corp. obtains 100% of the additional joint profits generated by a foreclosure strategy for several reasons. As our discussion of corporate governance has pointed out, the incentive and ability of DirecTV's audit committee to ensure arms-length contracting between News Corp. and DirecTV is limited.[30] In addition, we note that any split of the additional profits in excess of News Corp.'s ownership share would not make Hughes stockholders worse off. This is because any DirecTV profits achieved through foreclosure would result directly from the actions of News Corp., and those profits would not otherwise be available to Hughes stockholders. The proposed joint endeavors between News Corp. and DirecTV that are a basis for many of the Applicant's claimed benefits provide ample opportunities to compensate News Corp. for the losses in programming revenue associated with foreclosure and make the strategy profitable for both firms and their stockholders.

8. Applicants calculate the critical value based on the average advertising revenues of all News Corp. owned and operated stations as well as average market shares of cable and DBS in the United States.[31] Applicants find that on average, it would not be profitable to engage in permanent

[23] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 13, JCC Aug. 4 Ex Parte, Rogerson Analysis II at 54.

[24] *2002 Annual Video Competition Report* ¶ 4.

[25] Applicants' Reply, CRA Analysis at 52.

[26] JCC Aug 4 Ex Parte, Rogerson Analysis II at 11; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 18.

[27] Applicants' Reply, CRA Analysis at 53.

[28] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 11.

[29] Hughes Electronics Corporation, SEC Form S-4, June 5, 2003 at 26.

[30] *See* Section IV.C.2.

[31] Applicants' Reply, CRA Analysis ¶ 73.

advertising revenues from those consumers that remain with the rival MVPDs but no longer receive the local broadcast station's signal Since the signal remains available over the air, some fraction of the rival MVPD viewers will continue to watch News Corp. broadcast programming, therefore reducing the economic loss suffered by News Corp. News Corp. stands to gain a share of the additional profits DirecTV will earn from the consumers that switch from rival MVPDs as well as the advertising revenues those new subscribers generate for the local broadcast station. Our critical value is then the number of rival MVPD subscribers that must switch to DirecTV in order for the revenue loss from the foreclosure to equal the revenue gain to News Corp.[8]

3. The analysis requires a number of values to complete the calculation. News Corp. has provided information on the advertising revenues earned by each of its broadcast stations and the Fox broadcast network, and in the absence of any objections from commenters, we accept these values as presented.[9] In addition, we use information on the advertising revenues of independently owned local affiliates from the BIA Master Access Database. Applicants also have presented calculations on the additional profit, or profit margin, DirecTV earns on each additional subscriber. Applicants use a value of **[REDACTED]** before factoring in a subscriber acquisition cost of **[REDACTED]** per subscriber.[10] Cablevision questions the values used by Applicants, and instead suggests that a more reasonable value would be $29.84 prior to factoring in subscriber acquisition costs.[11] They base their proposal on an unexplained analysis of SEC filings. We find Applicants' detailed documentation of DirecTV revenues, variable costs, and subscriber acquisition costs convincing, and will use these values in our analysis. We also must account for the fact that subscriber acquisition costs are a one-time expense associated with the acquisition of a new customer. To do this we follow the standard method, used by both Applicants and commenters, of amortizing those costs over the length of time that the subscriber is expected to stay with DirecTV.[12] To perform the amortization, two values are required, the average tenure of a subscriber and an appropriate discount, or interest, rate to use in spreading out the one-time cost over the tenure of the subscriber. Cablevision assumes the average tenure of a subscriber to be 60 months based on an analyst's report,[13] while Applicants report that the actual value for DirecTV subscribers is **[REDACTED]** months.[14] We will use an average subscriber tenure of **[REDACTED]** months since DirecTV is likely to have more accurate information regarding its subscribers than is an unaffiliated analyst, though we note that the difference between these two values is relatively minor. The difference between the discount rates used by Applicants and JCC in their analyses is more substantial. Applicants use a rate of **[REDACTED]**, based on the so-called hurdle rate used by

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[8] Mathematically, the critical value is $\left[\dfrac{(1-a)\bullet(Ad\ Revenue)\bullet(RivalMVPDSubs)}{s\bullet(DTV\ Profits)+(Ad\ Revenue)}\right]$, where 'a' represents the fraction of rival MVPD subscribers that obtain the News Corp. broadcast programming off of the air and 's' represents the share of DirecTV profits that will accrue to News Corp.

[9] News Corp. July 28, 2003 Response **[REDACTED]** and Applicants' Reply, CRA Analysis ¶ 70.

[10] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23 and DirecTV July 30, 2003 Response **[REDACTED]**.

[11] Cablevision Sept 25 Ex Parte, Rubinfeld Analysis II at 11-12.

[12] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 29.

[13] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 16, citing SG Cowen, *DBS Sector Upgrade*.

[14] Applicants' Sept 8 Ex Parte, CRA Analysis II ¶ 23.